

# Introduction to Timber Taxation

## Tennessee Department of Agriculture, Division of Forestry

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Forest tax regulations are complex and subject to change. Many IRS agents and accountants are unfamiliar with them, so it is usually up to landowners to educate themselves. The following brief checklist is intended only to alert the reader to certain important points.

**It is important to establish a cost basis and keep it current.** Cost basis is your investment in the timber. You can deduct the basis from your income when you sell the timber. Having a basis also allows you to claim a loss if the timber is destroyed suddenly and unexpectedly. A forestry consultant can help you establish a cost basis, even if the land was purchased years ago.

**Capital gains** are taxed at a much lower rate than regular income, and are exempt from the self-employment tax that must be paid on timber sales reported as ordinary income. You can also deduct your basis in the timber when it is sold, thus lowering your taxes.

### **Decide on your IRS status as a timber seller.**

- Hobbyist
- Investor (many absentee owners fall in this category)
- Owner of a trade or business in which you do not actively participate
- Owner of a trade or business in which you actively participate

Each has advantages and disadvantages, depending on your situation. Active participation is the most desirable status for most taxpayers, since it allows for you to deduct timber management costs against income from any source. The IRS has six tests to help determine whether your management is active or passive:

1. you participated more than 500 hours
2. your effort was “substantially all” the activity
3. you did more than 100 hours, which was more than anyone else

4. all related activities of more than 100 hours that don’t of themselves meet the material participation test add up to more than 500 hours
5. you materially participated in five of the last 10 years
6. all facts & circumstances show you materially participated (not advisable)

**Deductions.** Many costs of owning, managing and selling timber may be deductible from your gross adjusted income, depending on your tax status and the nature of the expense. **Good records are important** for you and your tax accountant in claiming and defending deductions.

**Reforestation tax credit and amortized deductions.** If you are growing timber for sale, you can claim 10% of reforestation costs of up to \$10,000 as a tax credit and deduct 95% of reforestation costs over a 7-year period.

**Greenbelt status,** obtained through the county tax assessor, will reduce your property taxes.

### **Web Sites**

National Timber Tax Web Site: [www.timbertax.net](http://www.timbertax.net)

Tax Tips for Forest Landowners:  
[www.r8web.com/spf/](http://www.r8web.com/spf/)

IRS publications and forms: [www.irs.ustreas.gov](http://www.irs.ustreas.gov)

Master Tree Farmer 2001 lectures:  
[www.MTF2000.net](http://www.MTF2000.net)  
(Code for access to outlines: “woodchip.”)

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